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No. 575

In the Supreme Court of the United States

OCTOBER TERM, 1931

NORTH AMERICAN OIL CONSOLIDATED, A CORPORATION, PETITIONER

v.

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

MEMORANDUM FOR THE RESPONDENT

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NORTH AMERICAN OIL CONSOLIDATED, A CORPORATION, petitioner

v.

DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT

The respondent does not oppose a limited review in this case.

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 130–145) is reported in 12 B. T. A. 68. The amended opinion of the Circuit Court of Appeals (R. 194–203) is reported in 50 F. (2d) 752.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered June 15, 1931. (R. 193–194.) Peti-

tion for rehearing was filed July 15, 1931, and was denied September 14, 1931. (R. 194.) Petition for a writ of certiorari was filed December 14, 1931. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether under Section 13(c) of the Revenue Act of 1916 it was the duty of the receiver of a part of the property or business of a corporation to file an income-tax return in respect of such part of the property or business.

2. Whether income received by such receiver was income taxable in the year in which he received it or in a later year when by court order he turned it over to the corporation.

STATUTES AND REGULATIONS INVOLVED

The applicable statutes and regulations are set forth in Appendix A, *infra*, pp. 13–17.

STATEMENT

The petitioner is a California corporation. During the years involved it was engaged in producing oil and derived income from oil wells on many parcels of land. (R. 92–111.) On July 15, 1913, the petitioner acquired by purchase a parcel of land described as Section 2, Township 32, Range 23 East M. D. B. & M., Kern County, California. (R. 116.)

Prior to November 30, 1915, suit was instituted by the United States in the United States District

Court for the Southern District of California to oust the petitioner from possession of this property, and on February 3, 1916, the Court entered an order appointing a receiver to operate or supervise the operation of the oil wells on this property and to receive the income arising therefrom. (R. 116–120.)

On June 5, 1917, the order appointing the receiver was vacated by final decree of the District Court (R. 120) and the bill was dismissed (242 Fed. 723). The government appealed and the Circuit Court of Appeals affirmed the decree of the lower court. (264 Fed. 336.) The case was brought to this Court where the appeal was dismissed under a stipulation of counsel. (258 U. S. 633.) See mandate of March 21, 1922. (R. 120–122.) On April 12, 1922, a patent to Section 2 was issued by the United States to certain applicants who had agreed to convey to the petitioner.

During the period February 2, 1916, to December 31, 1916, the receiver collected and impounded net income from the oil wells on the property amounting to $171,979.22. (R. 123.) This income had been entered on the books of the petitioner as its income and was reported in its amended return for that year. (R. 122.) It was actually turned over to the petitioner in June, 1917, at the time of the District Court's decree. (R. 123.)

Upon auditing the petitioner's income and profits tax returns for 1917, the Commissioner deter-

mined a deficiency of $109,239.61, the deficiency being based on other items. The petitioner appealed to the Board of Tax Appeals. In an amended answer to the amended petition filed January 29, 1927, the Commissioner prayed that the deficiency for 1917 be increased to $253,150.96 to include the tax on the income of $171,979.22 paid over by the receiver in that year. (R. 45–48.)

The Board of Tax Appeals held that the sum in question was not taxable to the petitioner in 1917 but was taxable to the receiver in 1916 irrespective of whether the petitioner was on the accrual basis or on the cash receipts and disbursements basis and found a deficiency of only $35,806.30. (R. 145–146.)

Upon appeal to the Circuit Court of Appeals for the Ninth Circuit that court reversed the decision of the Board, holding that the receiver, as a receiver of less than all of the property of the petitioner, was not required to file a return in its behalf for 1916, and that the income was taxable to the petitioner for 1917. (R. 194–203.)

ARGUMENT

The decision below first dealt with the question as to whether Section 13 (c) of the Revenue Act of 1916, requiring receivers operating the property or business of corporations to make returns of net income as and for such corporations, applied in circumstaces like those of this case where the receiver was the receiver of a part only of the property or business of the petitioner, and the holding was

that Section 13 (c) did not so apply and accordingly the receiver was not required to file a return. The court then considered whether the income in question was income of the corporation in the year 1916, when it was received by the receiver, or in the year 1917, when, by court order, the receiver was directed to turn over such income to the corporation, and the decision was that such income was not taxable to the petitioner in the year 1916.

In so far as the petition for certiorari involves the question whether the court below correctly decided that the income was taxable to the corporation for 1917, we do not oppose the petition. Since the petition was filed in this case, the Circuit Court of Appeals for the First Circuit has decided a closely analogous question in a way which, if it does not establish a principle directly in conflict with the decision in the case at bar, at least creates great confusion as to the principle for which each case may be said to stand. See *Commissioner* v. *Brown*, 18 B. T. A. 859, decided by the Circuit Court of Appeals December 17, 1931, but not yet reported. (Portions of such opinion are printed in Appendix B.)

In the *Brown* case, during 1918 and 1919 a partnership was a licensed wool dealer under certain governmental regulations which required it to set aside on its books all amounts received in excess of 5% of the gross profits on the season's business, with the understanding that such excess would ulti-

mately be returned to the growers in such manner as the Government should decide. Litigation ensued between the government and the partnership as to the ownership of the excess profits which was not terminated until 1930, when a final decision was rendered for the taxpayer. The court decided that the excess profits were not accrued income of the taxpayer for 1918, when payments for the wool were received, but only when the controversy as to the partnership's ownership thereof had been determined in its favor.

It will be noted that in the *Brown* case the Board of Tax Appeals definitely found that the taxpayer was on an accrual basis, whereas in the instant case no finding was made as to whether the petitioner kept its books and rendered its return on the cash receipts and disbursements basis or on an accrual basis, and that the court attributed no significance to the accounting method employed (R. 201), but held that, irrespective of the method employed, the income was taxable to the corporation for 1917 when the receiver was discharged. The returns themselves indicate that they were filed on the cash basis (R. 169, 178), but there is some slight evidence to the contrary (R. 24, 67, 68, 72). In view, therefore, of the court's decision that the income in this case would be taxable for 1917, irrespective of the basis of filing the returns, it can not be said that the instant case is so clearly distinguishable from the decision in the *Brown* case that the exercise of the supervisory power of this Court is unnecessary.

The extent to which each should be accepted as authority is uncertain. We believe that the decision in the *Brown* case is clearly wrong and the propriety of filing of a petition for a writ of certiorari in that case is under consideration.

As to the first point considered by the court below, i. e., the applicability of Section 13 (c) of the Revenue Act of 1916 to the receiver in this case, we submit that the holding below is correct, that the income received by the receiver in 1916, and returned to petitioner by court order in 1917, was properly taxable to the corporation and not to the receiver.

Sections 10 and 13 (a) of the Revenue Act of 1916, *infra,* require every corporation to file a return of gross income and deductions and to pay a tax on its net income from all sources disclosed by this return.

The petitioner contends that it was relieved of the necessity of reporting the income held by the receiver in 1916 because that duty was placed upon the receiver by Section 13 (c) of the Revenue Act of 1916, *infra,* which provides:

> In cases wherein receivers, trustees in bankruptcy, or assignees are operating the property or business of corporations, joint-stock companies or associations, or insurance companies, subject to tax imposed by this title, such receivers, trustees, or assignees shall make returns of net income as

> and for such corporations, joint-stock companies or associations, and insurance companies, in the same manner and form as such organizations are hereinbefore required to make returns, and any income tax due on the basis of such returns made by receivers, trustees, or assignees shall be assessed and collected in the same manner as if assessed directly against the organizations of whose businesses or properties they have custody and control.

This provision was not changed in the amendments of the Revenue Act of 1916 made by the Revenue Act of 1917.

The Circuit Court of Appeals held—correctly, we submit—that this provision did not apply to a receiver operating only a part of the property of the petitioner.

The statute refers to receivers, trustees in bankruptcy, or assignees who "are operating the property or business of corporations * * *." The use of the word "the" in this phrase plainly means that it is only where the receiver is in charge of all of the property or business of a corporation that he is required to make a return of income in behalf of the corporation. This conclusion is fortified by the fact that the trustee or receiver is required to make returns of net income "as and for such corporations" and the tax due thereon is to be assessed and collected "in the same manner as if assessed directly against the organizations of whose businesses or properties they have custody and con-

trol." Thus only where the receiver is in entire charge of the property or business of the corporation is he substituted for the corporation and becomes liable for tax in its stead. See *Reinecke* v. *Gardner,* 277 U. S. 239. Further, the regulations of the Treasury Department have consistently construed the provisions of the various statutes relating to receivers, whether of individuals or corporations, as applying exclusively to those in complete charge of the business or property of the taxpayer. While Articles 26 and 209 of Regulations 33, *infra,* do not specifically mention receivers in charge of part of the property or business, by reference to receivers standing in the stead of their principals in the case of individuals and to the suspension of powers in the case of corporations it seems perfectly clear that receivers of the former class are excluded.

Articles 424 and 622 of Regulations 45, *infra,* embody the same rule in more specific language. True, Articles 424 and 622 of Regulations 45 were promulgated under the Revenue Act of 1918, Section 225 of which specifically exempts from the requirement of filing returns receivers in possession of part only of the property of an individual; but notwithstanding that, Section 239 of that statute made no corresponding change as to receivers of corporations and the Treasury Department made the same regulations as to both and did not change them in substance from what they had been under the Revenue Act of 1916.

To the same effect are Articles 424 and 622 of Regulations 62, 65, and 69 and Article 392 of Regulations 74.

This settled administrative construction is entitled to great weight, particularly since Congress during the period that the regulations were in effect repeatedly reenacted provisions relating to receivers,[1] which, in so far as corporations were concerned, were identical in all material respects with Section 13 (c) of the Revenue Act of 1916. *Brewster* v. *Gage*, 280 U. S. 327, 336; *National Lead Co.* v. *United States*, 252 U. S. 140, 145–146. If the departmental construction of Section 13 (c) of the Revenue Act of 1916 had been deemed incorrect, Congress would no doubt have changed the law in the revisions of 1918, 1921, 1924 or 1926. See *Heiner* v. *Colonial Trust Co.*, 275 U. S. 232, 235.

The regulations were obviously reasonable. To hold that a receiver such as the receiver in this case should return a part of the income of a corporation, and that the corporation should return the balance, would in many instances give a corporation so situated an undue advantage as to credits allowed in computing the tax (see, for example, Sections 202 and 203 of the Revenue Act of 1917,

[1] See Section 239 of the Revenue Act of 1918, c. 18, 40 Stat. 1057, 1081; Section 239 (a) of the Revenue Act of 1921, c. 136, 42 Stat. 227, 259; Section 239 (a) of the Revenue Act of 1924, c. 234, 43 Stat. 253, 287 (U. S. C., Title 26, Section 991); Section 239 (a) of the Revenue Act of 1926, c. 27, 44 Stat. 9, 45 (U. S. C. App., Title 26, Section 991).

c. 63, 40 Stat. 300), and as to the allocation of income in the different brackets on which different rates of profits taxes are imposed (see, for example, Section 201 of the Revenue Act of 1917). There is no provision in the Act for the consolidation of the return of the receiver of part of a corporation's property and the return of the corporation itself.

The case of *Forstmann* v. *Ferguson*, 17 F (2d) 659, affirmed (C. C. A. 3rd), 25 F. (2d) 47, is not *contra*. That case did not involve any consideration of the duty of a receiver or trustee in bankruptcy to file returns, but dealt only with the duty in that respect of a fiduciary, under Section 219 of the Revenue Act of 1918. It was there held that where a corporation had been directed by court order to refrain from paying dividends on stock which had been seized by the Alien Property Custodian, the corporation should file a fiduciary return as trustee with respect to such dividends.

CONCLUSION

We do not oppose the granting of the petition, but we suggest that the writ should confine the question to be considered by this Court to the single question as to the year in which the income was taxable. We submit that the decision below correctly decides that Section 13 (c) of the Revenue Act of 1916 does not apply to receivers operating a part of the business of corporations, and that so much of the petition as relates to that should be denied.

As to the latter question there is no conflict of decision and the question presented is not of general importance.

Respectfully submitted.

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JANUARY, 1932.

APPENDIX A

Revenue Act of 1916, c. 463, 39 Stat. 756:

SEC. 10. That there shall be levied, assessed, collected, and paid annually upon the total net income received in the preceding calendar year from all sources by every corporation, joint-stock company or association, or insurance company, organized in the United States, no matter how created or organized but not including partnerships, a tax of two per centum upon such income; * * *

SEC. 12. (a) In the case of a corporation, joint-stock company or association, or insurance company, organized in the United States, such net income shall be ascertained by deducting from the gross amount of its income received within the year from all sources— * * *

SEC. 13. (a) The tax shall be computed upon the net income, as thus ascertained, received within each preceding calendar year ending December thirty-first: * * *

* * * * *

(c) In cases wherein receivers, trustees in bankruptcy, or assignees are operating the property or business of corporations, joint-stock companies or associations, or insurance companies, subject to tax imposed by this title, such receivers, trustees, or assignees shall make returns of net income as and for such corporations, joint-stock companies or associations, and insurance companies, in the same manner and form as such

organizations are hereinbefore required to make returns, and any income tax due on the basis of such returns made by receivers, trustees, or assignees shall be assessed and collected in the same manner as if assessed directly against the organizations of whose businesses or properties they have custody and control; * * *.

Revenue Act of 1918, c. 18, 40 Stat. 1057, 1074, 1081:

SEC. 225. That every fiduciary (except receivers appointed by authority of law in possession of part only of the property of an individual) shall make under oath a return for the individual, estate or trust for which he acts (1) if the net income of such individual is $1,000 or over if single or if married and not living with husband or wife, or $2,000 or over if married and living with husband or wife, or (2) if the net income of such estate or trust is $1,000 or over or if any beneficiary of such estate or trust is a nonresident alien, stating specifically the items of the gross income and the deductions and credits allowed by this title. Under such regulations as the Commissioner with the approval of the Secretary may prescribe, a return made by one of two or more joint fiduciaries and filed in the office of the collector of the district where such fiduciary resides shall be a sufficient compliance with the above requirement. The fiduciary shall make oath that he has sufficient knowledge of the affairs of such individual, estate or trust to enable him to make the return, and that the same is, to the best of his knowledge and belief, true and correct.

SEC. 239. That every corporation subject to taxation under this title and every per-

sonal service corporation shall make a return, stating specifically the items of its gross income and the deductions and credits allowed by this title. The return shall be sworn to by the president, vice president, or other principal officer and by the treasurer or assistant treasurer. If any foreign corporation has no office or place of business in the United States but has an agent in the United States, the return shall be made by the agent. In cases where receivers, trustees in bankruptcy, or assignees are operating the property or business of corporations, such receivers, trustees, or assignees shall make returns for such corporations in the same manner and form as corporations are required to make returns. Any tax due on the basis of such returns made by receivers, trustees, or assignees shall be collected in the same manner as if collected from the corporations of whose business or property they have custody and control.

* * * * *

Treasury Regulations 33:

ART. 26. * * *

RULINGS ON MAKING RETURNS

* * * * *

181. Receivers who, as officers of a court, stand in the stead of some principle are required to account for income tax as the principal would have been required to account.

* * * * *

ART. 209. *Receivers to make returns.*—Section 13, paragraph C, of this title requires receivers, trustees in bankruptcy, or assignees, who are in charge of and are operating the property and business of corporations, to make returns of annual net in-

come and pay any income tax thereby shown to be due, regardless of what disposition, subject to the orders of the court, may be made of such income.[1]

Notwithstanding the fact that the powers and functions of the corporation are suspended and that the property and business are for the time in control and custody of the receiver, trustee, or assignee, subject to the orders of the court, such receiver, trustee, or assignee stands in the place of the corporate officers and is required for the purpose of this title to perform all the duties and assume all the liabilities which would devolve upon the officers of the corporation were they in control. The income which he receives on account of the business transacted is the income of the corporation and, no matter how such income is applied, it is subject to the tax imposed by this title in so far as it exceeds the deductions or allowances authorized by law.

The receiver, trustee, or assignee acting for the corporation, is required to make a true and accurate return of annual net income covering each year or part of each year during which he is in custody and control of the business or properties and will be liable to all the penalties imposed by this title for failure to meet any of its requirements.

Treasury Regulations 45:

ART. 424. *Return by receiver.*—A receiver who stands in the stead of an individual or corporation must render a return of income and pay the tax for his trust, but a receiver of only part of the property of an individual or corporation need not. If the receiver acts for an individual the return shall be on form 1040 (revised) or 1040 A (revised).

When acting for a corporation a receiver is not treated as a fiduciary, and in such a case the return shall be made as if by the corporation itself. See section 239 of the statute and article 622. A receiver in charge of the business of a partnership shall render a return on form 1065 (revised). A receiver of the rents and profits appointed to hold and operate a mortgaged parcel of real estate, but not in control of all the property or business of the mortgagor, and a receiver in partition proceedings, are not required to render returns of income. In general, statutory receivers and common-law receivers of all the property or business of an individual or corporation must make returns. See also section 256 of the statute and articles 1071–1080.

ART. 622. *Returns by receivers.*—Receivers, trustees in dissolution, trustees in bankruptcy, and assignees, operating the property or business of corporations, must make returns of income for such corporations on form 1120, covering each year or part of a year during which they are in control. Notwithstanding that the powers and functions of a corporation are suspended and that the property and business are for the time being in the custody of the receiver, trustee, or assignee, subject to the order of the court, such receiver, trustee, or assignee stands in the place of the corporate officers and is required to perform all the duties and assume all the liabilities which would devolve upon the officers of the corporation were they in control. A receiver in charge of only part of the property of a corporation, however, as a receiver in mortgage foreclosure proceedings involving merely a small portion of its property, need not make a return of income. See articles 424 and 547.

Appendix B

United States Circuit Court of Appeals for the First Circuit. October term, 1931. No. 2578. *Commissioner of Internal Revenue, petitioner for review,* v. *Jacob F. Brown.* No. 2583. *Jacob F. Brown, petitioner for review,* v. *Commissioner of Internal Revenue.* Appeals from Board of Tax Appeals. Before Bingham, Wilson, and Morris, *J. J.* Opinion of the Court. December 17, 1931.

Wilson, *J.*: These are petitions for review of decisions of the Board of Tax Appeals affirming in part a decision of the Commissioner of Internal Revenue assessing the income tax of the partners of Brown & Adams, wool dealers in the city of Boston, for the calendar year of 1918, and overruling the Commissioner in refusing to allow as a deduction to Jacob F. Brown in 1918 the cost of certain Japanese bonds sequestered by the German government during the war as alien enemy property.

The partnership of Brown & Adams was composed of six co-partners, each of whom is a petitioner for review, but by stipulation the tax of the other five co-partners are to be determined by the decision in the case of Jacob F. Brown, petitioner.

The two cases involve three main issues, first, whether the profits from handling the 1918 wool clip as licensed dealers under certain government regulations was income received in 1918; second, whether certain contingent charges made in 1918

for financing a textile corporation of which the partnership was a creditor was income in 1918; and, third, whether certain Japanese bonds belonging to Jacob F. Brown, on being sequestered by the German government in 1918, could properly be treated as a loss within the meaning of Sec. 214 (a) (5) of the Act of 1918.

WOOL PROFITS

With reference to the issues raised by the profits from handling the wool clip of 1918, the Board of Tax Appeals found the following facts:

> The partnership kept its accounts in accordance with an accrual method. During a part of the years 1918 and 1919 the partnership did business as an approved dealer on a permit issued by the Wool Division of the War Industries Board, as provided in the Board's Regulations of May 21, 1918, said regulations providing among other things that the Government should have a prior right to acquire all of the 1918 wool clip at prices to be officially fixed, plus 4 percent of the selling price as compensation for distribution services, and that the approved dealers should sign an agreement that their books would at all times be open to Government inspection, that they would operate subject to the Board's rules, and if at the end of the season it should be found that their gross profits (including the commission) were in excess of 5 per cent of the "season's business," then such gross profits should be disposed of as the Government decided.
>
> Upon dissolution of the War Industries Board, December 31, 1918, its powers and

functions, including those relating to payments required by regulations affecting the wool clip, were transferred by presidential order to the Bureau of Markets, Department of Agriculture, which on May 20, 1919, announced that the excess profits would be returned to the growers, and expressly prohibited the dealer from undertaking to make any adjustment with the grower, "no disposition of any excess profits" being authorized until such time as written instructions were given by the chief of the Bureau of Markets.

The wool clip of 1918, affected by the regulations, referred to wool grown and clipped in that year. Clipping is done from February to the middle of June and the "season's business" is from spring to spring, the dealer making purchases in the spring for a twelve months' supply, which is ordinarily sold or delivered by the following March or April.

Brown & Adams made substantial purchases of the 1918 wool clip, not all of which was sold and delivered until April, 1919. The partnership's journal entries of September, 1919, show sales of this clip under eight accounts, which had not closed at the end of 1918, there being a material amount of the wool then unsold. Although the partnership used the inventory method to compute the 1918 profits on wool not here in controversy, it took no inventories of the 1918 wool clip. Data from which such inventories could have been made have been continuously available.

At the end of 1918 the partnership noted the amount of wool which it had billed to the Quartermaster Corps, entering on its books as its profits for 1918 5 percent of such

business in that year. Further sales of the 1918 clip were made in 1919, and after the eight accounts were closed a new account entitled "Whom It May Concern" was set up February 24, 1919, composed of the excess profits in the eight accounts from the "season's business." In computing these excess profits, the 5 percent profit allowed by the Government's regulations were subtracted from the net profits and the total of the resulting differences, $253,254.77, was taken to represent the excess profits on the 1918 clip, no matter when sold. The account was set up pursuant to a request from the Bureau of Markets for information concerning the firm's disposition of all wool bought of the clip of 1918. Government auditors later disallowed certain charges taken in connection with the sales, and the account was increased, December, 1919, to $268,947.16.

Representatives of the War Industries Board orally and later by letters dated December 8 and December 20, 1919, made formal demand upon the partnership for immediate payment of these excess profits. The partnership did not comply, petitioner Brown advising the Government representative that he regarded the *pro rata* distribution, contemplated by the Government, of the excess profits to the growers as unfair, since some had received 65 cents and some 70 cents a pound for their wool. Brown offered to go over all the partnership's accounts with the individual growers and check up the grading of the wools and the prices realized, and, after working out the amount to which each grower was entitled, to send the Government the partnership's check for "Whom It May Concern" account.

The Government representative refused to agree to this method.

The "Whom It May Concern" account was thereafter taken out of the partnership's books, but later reinstated, being charged back to the partners. The Commissioner refused to regard the entire amount of these excess profits as income in 1919, but divided it between 1918 and 1919, segregating between the two years an amount of $301,922, made up of the $268,947.16 aforesaid, and about $33,000 credited from the interest account to profit and loss. This segregation was made by allocating to 1918 that proportion of the total profits which gross sales for that year was of gross sales for the entire season. The absence of inventories of the "restricted wool" was given in the agent's report as the reason for this method of allocation.

On June 2, 1922, the United States filed a suit in the district court for the District of Massachusetts against Jacob F. Brown et al., doing business under the firm name of Brown & Adams, for payment to the plaintiff of $295,051.63 with interest, alleging that defendants became bound to pay plaintiff said sum as excess profits on wool handled by them in 1918 by virtue of the aforesaid Government regulations and the defendant's agreement to operate subject thereto. The difference between the amount of the liability as set up on its books by the partnership and the amount for which the Government has brought suit is due to the exclusion by the Bureau of Markets of certain items of cost used by the partnership in computing the excess profits.

If all the wool had been consigned to the dealers under government regulations it would have elim-

inated any excess profits, but the wool growers in general refused to consign their wool to the dealers and trust to the government grading and possible delay in receiving their money. They preferred cash when their wool was delivered to a dealer or the usual terms of payment. The dealers in the majority of cases proceeded to handle the purchase and collection of the wool as usual, paying the grower whatever price could be agreed upon. The dealers then collected and stored and delivered the graded wool on Quartermaster's orders and at the price fixed by the government. To protect themselves against government grading and the expense of scouring, shipment, and storage, the dealers made the best bargains they could with the growers. In consequence Brown & Adams on the 1918 clip netted a considerable sum in excess of the 5 per cent profit allowed under the regulations of the Board.

In making up their income tax return for 1918, the partners reported as income from handling the 1918 wool clip their proportionate shares of 5 per cent of the gross sales to the government during that year, or $229,655.67, that being the maximum amount a dealer was allowed to retain under the Regulations of the War Industries Board for his services or profits as an approved dealer.

As a matter of fact the partnership finally received as net profits in handling the wool clip of 1918 over $500,000. Of the wool thus handled by Brown & Adams only a small amount, seven or eight per cent, was left for disposal in 1919, but the entire profits of the partners were not determinable until 1919.

The partnership, however, on the theory that it was not entitled to any profits over the 5 per cent

on its gross sales, but must return any excess profits to the government to be returned to the growers of whom it purchased the wool, in good faith carried in 1919 the excess profits to an account entitled "Whom It May Concern."

In 1919, as the Board found, the government made a demand on the partnership for the amount of these excess profits. The partners on learning of the manner in which the government proposed to distribute this sum, was advised by counsel that it was illegal and might involve them in litigation with the growers, and that it could not be equitably distributed in the manner proposed by the government for reasons set forth in *United States* v. *McFarland*, 15 Fed. (2d) 823, and *United States* v. *Brown*, 39 Fed. (2d) 851, which it is unnecessary to repeat here. The partnership thereupon refused to pay to the government the amount it had carried to the account of "Whom It May Concern" until it was determined who was entitled to it, or some equitable method could be devised for its distribution among the growers from whom the partnership had purchased the wool.

The action brought by the government in 1922 to recover of the partnership such excess profits was decided against the government in 1930; *United States* v. *Brown, supra.*

The Commissioner in assessing the deficiency tax for 1918 held, and his decision was affirmed by the Board of Tax Appeals, that having received in 1918 under his method of allocation this additional sum of approximately $270,000 as profits from the sale of the 1918 wool clip, it constituted income during that year, notwithstanding at that time the partnership made no claim to it, and until settled by the

suit in 1930, the government insisted that the partnership was not entitled to retain it.

The petitioner, however, now not only contends that the profits received by the partnership in excess of 5 per cent should not be treated as taxable income until the right to it was determined, but also further contends, notwithstanding the partners returned as income in 1918 5 per cent on its gross sales of wool to the government during that year, that they should not be charged with any income at all in 1918 resulting from the sale of the 1918 wool clip; that the handling of this wool clip should be treated as a single transaction, and as the wool season extends from April to April, and the partnership had not on December 31st, 1918, received from the sale of the wool clip of that year the total cost and expenses of handling the entire clip—though as a matter of fact the difference was small—no profits resulted until the cost of the wool and expense of handling had been met, which did not occur until 1919, and therefore he should not be taxed for any income from this source until 1919.

We think the partners were right in including in their tax returns for 1918 their proportional part of the sum represented by 5 per cent of the gross sales to the government for that year, and their present contention in this particular can not be sustained. The profits during the year 1918 of 5 per cent allowed by the government regulations on the gross sales were readily determinable at the end of the year, and as it was highly improbable that the remainder of the wool on hand January 1st, 1919, whether taken by the government or not, would fail to net the partnership sufficient to cover the balance of the cost and expenses of handling,

there was not sufficient ground for postponing the determination of their profits of 5 per cent until the entire 1918 wool clip handled by them was sold, especially since it appears from the record in the case that there was a marked improvement in the wool textile industry in 1919. We think ordinary business judgment would approve the course adopted by the partners in their 1918 return, since their books were kept on an accrual basis.

But we think the government was not entitled to have included in the 1918 return of the partners as income the excess profits above 5 per cent which the government insisted up to 1930 that the partnership had no right to retain, and to which the partners at that time made no claim, but themselves proposed in 1919 a plan of distributing it among the growers of whom the wool had been purchased and to whom the partners then claimed the excess belonged, and in which plan of distribution they offered to cooperate with the government.

The defense of the action brought by the government does not estop the partners from contending that the profits in excess of 5 per cent were not income received in 1918. The partners had contended that the government had no right to recover them to be disposed of in the manner proposed, even though the partnership had no right to retain them, and, further, that by reason of the invalidity of the Regulations, the government had no right to direct their disposition for any purpose. The petitioner was obliged to defend the action as well as the claim that the excess profits were taxable as income, or take the risk of being compelled to pay a judgment for the full amount as well as the

amount of the income tax on the same, if he acceded to the assessment by the Commissioner.

On the other hand, as the court said in *R. Hoe & Co.* v. *Commissioner,* 30 Fed. (2d) 630, 633: "It is hard to see why one department of the government could not bind another as to the extent of this loss." There appears to be no good reason why the same reasoning does not apply to gains as well as losses. The Bureau of Markets representing the executive department having set up the claim that the excess profits did not belong to the partners, "it is hard to see," as the court said in the above case, how such excess profits could consistently be treated as income for another branch of the executive department.

On this branch of the case the decisions in *Frederick McLean Bugher et al.,* 9 B. T. A. 1155; *McMurray* v. *Reynolds,* 38 Fed. (2d) 480, 482; *Peninsula Shipbuilding Co.,* 9 B. T. A. 189, 203; *Ansco Photo Products, Inc.* v. *Clark,* 34 Fed. (2d) 569; *Sanford & Brooks Co.,* 11 B. T. A. 452, affirmed 282 U. S. 359, 568; *Thorne Neale & Co., Inc.,* 13 B. T. A. 490, 495; *Northwestern Improvement Co.* v. *Commissioner,* 14 B. T. A. 79, 86; *Great Northern Railway Co.,* 8 B. T. A. 225, 269, support the petitioner's contention if they are not controlling.

In the last case cited, the Board of Tax Appeals said:

> Under either method (that is, cash or accrual) the taxpayer must have before him some definitely ascertained item of income to record before it can be reported and if a given transaction does not correspond to the definition of income then there is no income to record whether the taxpayer keeps its books on a cash or an accrual basis.

> Where books are kept on an accrual basis there is no requirement that there shall be accrued as income that which may never be received.

It is equally true, we think, that a taxpayer is not required to report as accrued income that which he may never be permitted to retain, because his right to it has not been determined, since "generally speaking, the income-tax law is concerned only with realized gains." *Burnet* v. *Logan*, 283 U. S. 404, 413; *Lucas* v. *American Code Co.*, 280 U. S. 445, 449.

Again in *Peninsula Shipbuilding Co.*, 9 B. T. A. 189, 203, the Board said:

> We will consider first the question whether claims made by the petitioner against the Emergency Fleet Corporation for depreciation as an element in determining the cost of the vessels built during the taxable year were accruable items. In numerous appeals the Board has held that disputed and contested claims not set up on the books of account of taxpayers are not accruable items of income or deductions therefrom until the year of actual settlement.

In *McMurray* v. *Reynolds*, 38 Fed. (2d) 480, 482, the court held:

> Whatever the rule is in regard to what constitutes income, I think it should be determinable upon the conditions and the circumstances which surround the transaction immediately at the close of the taxable year. If it then is determinable as income, it is likewise taxable; if it is not then determinable as income, it is not taxable, and can not, on account of conditions growing out of future contingencies, be made taxable.

* * * * *

In No. 2578, decision of the Board of Tax Appeals is affirmed.

In No. 2583, the decision of the Board of Tax Appeals is reversed and the case is remanded to that Board for further proceedings not inconsistent with this opinion.

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